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REFORMS OF FINANCING PENSION INSURANCE SYSTEM IN CONDITIONS OF TRANSITION

РЕФОРМЕ СИСТЕМА ФИНАНСИРАЊА ПЕНЗИОНОГ ОСИГУРАЊА У УСЛОВИМА ТРАНЗИЦИЈЕ

Summary: *A serious crisis of the pension system has been present in Bosnia and Herzegovina, as well as in many other countries for many years. The current system, which functions on the concept of intergenerational solidarity is financially unsustainable, due to negative demographic and economic movements, as well as reduced number of the employed, and an increase in the number of pensioners. As the main objective of the pension system (the social security of citizens, ie protection against the risk of old age, disability and death) is not fulfilled, it seems that the reform of the pension system is necessary. It is necessary to answer the question: how to transform the pension system of intergenerational solidarity in a system of individual capitalized savings in a socially painless and affordable way?! The implementation of the pension reform aims to establish a long-term sustainable pension system that will provide quality protection from risk, old age, death, disability, and at the same time be consentaneous with economic and demographic movements and ensure an adequate level of benefit to citizens in the later age.*

The aim of the paper is to define the wider, objective picture of the current state of the position of the pension system, as well as providing basic guidelines for the reform and development courses in the future.

Keywords: *system of social security, reform of pension system, public finances, contributions*

JEL classification:

Резиме: *У Босни и Херцеговини, као и у великом броју земаља, већ дужи низ година присутна је озбиљна криза пензионог система. Тренутни систем који функционише на концепту међугенерациске солидарности, услед негативних демографских и привредних кретања, те смањења броја запослених, и повећања броја пензионера, финансијски је неодржив. Како основни циљ пензионог система (социјална сигурност грађана, односно заштита од ризика старости, инвалидности и смрти) није испуњен, чини се да је неопходна реформа пензионог система. Потребно је дати одговор на питање: како на социјално најбезболнији, а опет, економски прихватљив начин трансформирати пензиони систем међугенерациске солидарности у систем индивидуалне капитализиране штедње?! Провођење пензионе реформе има за циљ да успостави дугорочно одрживи пензиони систем који ће пружити квалитетну заштиту од ризика, старости, смрти, инвалидности, а истовремено бити усклађен са привредним и демографским кретањима и осигурати адекватан ниво примања грађанима у познијем животном добу.*

Циљ рада је дефинисање широке, објективне слике о тренутном стању у коме се пензиони систем налази, као и давање основних смерница за реформске правце и развој у будућности.

Кључне ријечи: *систем социјалне сигурности, реформа пензионог система, јавне финансије, доприноси*

ЈЕЛ класификација:

1. FINANCING PENSION INSURANCE SCHEMES

Public expenditures on pensions are based on demographic and macroeconomic sizes. (Rakonjac Antić 2012, 6-7) The birth rate, duration of life, and migration flows, macroeconomic movements, dynamics of GDP, the rate of earnings, decrease of employment rate and social factors (marital status, early retirement, claims for disability pensions) are the most important elements that determine the movement state of the pension insurance funds sides. With regard to the assessment of

the amount of pension expenditures and the functioning of the pension system the following indicators are important: share of pension expenditures to GDP, which shows how society is burdened with these expenditures¹ as a whole (the lowest share in the OECD with South Korea - 1.9% and Ireland - 3, 2%, the average for OECD countries is 7.4%. the share of BiH in 2011, was 15%); the amount of the contribution rate for pension insurance, as a measure of the burden imposed on the insured pension insurance; the ratio of pensioners to the number of the insured; the ratio of the amount of the average pension per pensioner by the average taxable income per insured person, the employment rate and others. Lower employment rate has influence on reducing the contributions to the funding of public pension expenditures (Hrustić 2008).

The system of financing PDI insurance is organized institutionally or in the form of compulsory public insurance and private or a voluntary one in many countries (Stojanović et al. 2016). Public PDI Fund (the first pillar) functions on the basis of PAYG method, which means that the payment of social security charges are made from the payment of social security contributions of paid earnings, but it also includes budgetary transfers, loans and other assets in the absence of the funds collected from contributions, as in our country.³ Mandatory supplementary (the second pillar) insurance is a form of insurance where employees and employers pay defined contributions (in the form of a certain percentage of the gross earnings). The means of contributions and returns on invested means are located on individual pension accounts of employees in chosen pension funds. Private PDI (the third pillar) functions on the accumulation system or a capital increase so that the insured pay contributions for pension and disability insurance to individual accounts, either in companies in which they are employed, or in specialized financial institutions. Paid means are invested in different investment that yield returns that increase these funds (for example, purchase and sale of securities, real estate, etc.). After retirement the insured shall be entitled to a pension from these accumulated means (Ostojić 2011).

2. REFORMS OF THE PENSION SYSTEM IN COUNTRIES IN TRANSITION

All countries in transition from socialism and capitalism (except Bosnia and Herzegovina and Serbia), almost newfangled, accepted the "advice" from the experts of the World Bank and introduced a third pillar of voluntary insurance. If the authorities of these countries justified themselves that they do not have money for such an expensive reform, "the experienced world's banker", the IMF, would come to the scene and give billions and billions of credit, of course, with the condition of further interference in the interior economic policy. The aim, as well as any banker will always advise—to have security for its claim, and other macroeconomic aims usually stay in "tied the hands" of local authorities. And what are the results of the reform and the introduction of so-called "Chilean model" and voluntary insurance system?

Few countries can boast that they have provided higher pensions to its users thanks to this reform. On the contrary, only Slovenia (and eventually the Czech Republic) withstood the test of advisers of IMF to reduce the pensions because they will increase their competitiveness and continue to increase the standard of their pensioners, trusting more to their "Dežela"-Country and to the system of intergenerational solidarity. Except Poland and Hungary, none of the other transition countries can boast of the success of the pension system reform following the example of the Chilean model. On the contrary, Kazakhstan is the most obvious example of the bad effects. The owners of private capitalizing funds, cheated and robbed the insured according to the „pyramid“ in Kazakhstan. This was the direct cause that Kazakhstan authorities pay all obligations of the IMF and thank them for their cooperation and further economic advice. Analyzing the experience of countries in transition, according to the applied models and effects of the pension reform, the following can be distinguished as characteristic:

1. Hungary and Poland, which introduced the third pillar of pension insurance and thus circled the reforms that are considered the most successful;
2. Kazakhstan, which has accepted the Chilean model, but with the least successful reform of the pension insurance and

3. Slovenia which, in fact remained at the PAYG model with minor improvements to the second pillar and can be considered extremely successful (observed through the fulfillment of obligations to pensioners)¹ (Ostojić 2011).

The undertaken reform attempts after the beginning of the World economic crisis improved the actual position of the economies of the countries in transition, so that the pension systems like Polish pension system is gradually returning to the state of fiscal balance. However, systemic reforms were not sufficient to achieve the sustainability of the pension system in many economies. The data in the table indicate that by 2050, expenditures aimed at pension fund will be reduced in relation to GDP in those economies that have undertaken reforms, such as Estonia, Latvia and Poland, but will increase from 6% to 7% in relation to GDP in the same period in economies that do not implement further reforms aimed at the efficient growth of pensions, as for example the Czech Republic and Slovenia.⁵

Numerous studies show that these economies have a bigger problem with tax evasion and inefficient administration in the collection of contributions.

3. ANALYSIS OF THE SITUATION IN BOSNIA AND HERZEGOVINA AND THE REPUBLIC OF SRPSKA

There is a notorious fact that supports the advocates of reform, and that is that the Pension Fund should be an active participant and the flying-wheel of progressive economic movements in the capital market, which it is not currently, for sure. However, there is also another fact, and this is an absolute lethargy of Pension Fund of the Republic of Srpska on the capital market. When you look at the structure of revenues of the Pension Fund it consists of: 1) Contributions for PDI 75.88% 2) Budget means 22.62%, 3) Borrowed means and the most important for this topic 4) Dividends and other income are only 1.5%. Thus the word 'fund' from this structure of the income structure loses its meaning. This is a classic "water tube" (PAYG system) of distribution of budget means and contributions from wages to pension users. Even that part of the work (income collection) is done by Tax Authority, the pension payments have been transferred to the Treasury recently.

It is essential that there is no PDI Fund on the capital market. Funds, though part of the overall public finances are not included in the treasury mode of business. The law allows and encourages the PDI Fund to realize its incomes through participation on the capital market. In a word, while it was expected from the PDI Fund to play a significant role on the capital market and the managing function of the privatized enterprises, it turned out quite the opposite - a marginal participation in the stock market and the complete apathy of the Fund representatives in terms of the management of the privatized enterprises (Stojanović et. al 2016).

Social contribution rates are much higher than all other taxes rates in BiH, and are high in comparison with neighboring countries as well. The overall rate of social contributions in FBiH amounts to 41.5% of gross wage. This is higher than in the RS (34.9%) or the OECD average (29.5%) or the EU-8 average (38.1 percent). Contribution rates are proportional and different from the standpoint of taxpayers and from the standpoint of the basis.⁶ According to the methodology of KPMG in Europe, Belgium has the largest tax wedge according to this methodology, and it is 47%. Belgium was chosen because it has the highest tax wedge among the countries included in this study. This percentage signifies that the 100 000 USD 47% is directed to the budget ie. funds and the rest of 53% goes to the employee. Out of this percentage 33.9% applies to income tax, and 13.1% to social security contributions. Then the second one is Greece with the amount of the tax wedge of 46.5%, followed by Croatia with 46.1%. Bosnia and Herzegovina has a tax wedge of 37.5% according to this methodology, Macedonia 22.7%, and Serbia 17%.

Exemptions from payment of contributions for compulsory social insurance are very rare and specific. There are two types of benefits related to contributions in the Law- exemptions and exclusions (Stojanović et al 2016).

When FBiH is concerned, war history increased the number of invalids - pension users. But the dependence rate is also influenced by the number of the insured, by high rates of unemployment and by growth of the informal labor market in countries in transition. These factors reduce the number

¹ In the Great Britain the pension insurance system „stands“ on three pillars a) basic country pension, b) supplementary country pension, i c) pension savings of citizens.

of insured, while the number of users increases at the same time. A small number of the insured and the relatively high spending on pensions make the basis of the problem of the pension system in FBiH. Spending on pensions in BiH is 9.4% of GDP, among the highest in comparison with countries with a high income .. FBiH is among the three largest consumers of pensions among the countries in transition. Spending growth in the FBiH is even more worrisome than the real number of pensioners. Spending has risen from 7.6% of GDP in 2005 to 9.4% of GDP by 2015, for a short period of eight years. Although part of it can be attributed to the fall in GDP in 2009 due to the financial crisis, which increased the share of spending on pensions.⁸

Table 1 Pension's indicators in FBiH in November 2015

	Federation of BiH		Republic of Srpska			
Number of the insured	453.631		286.792			
Number of pensioners	400.352	Old-age pension	205.156	251.511	Old-age pension	134.996
		Disablement pension	76.739		Disablement pension	40.044
		Family pension	118.457		Family pension	76.165
The dependency system rate	1,13		1,14			
The average monthly pension	366,38 KM	Old-age pension	405,91	303,44 KM	Old-age pension	393,81
		Disablement pension	325,34		Disablement pension	310,96
		Family pension	324,51		Family pension	283,17
Means for the financing of pensions	Contributions for PDI	on	Contributions for PDI	55,9 millions KM		
	Budget financing	on	Budget financing	15,8 millions KM		
Expenditures from pension payments	155,6 milions KM	/	82,3 millions KM	/		

Source: FZMIOPIO 2016 and Fond PIO RS 2016

Social security contributions are significant in scope, just behind indirect taxes. In the Republic of Srpska the amount of 1 billion, 466 millions KM was collected during 2015 (out of which the most was charged for the Pension Fund - 754.4 millions, the Health Insurance Fund collected 539.04 millions KM). In the Federation of BiH, the amount of 2.8 billion KM contributions was collected in 2015, out of which: contributions for pension and disability insurance in the amount of KM 1.57 billion, health insurance contributions collected the amount of 1.1 billion KM, and contributions for unemployment insurance in the amount of 127.4 million KM.

Comparing the dependency rates in RS with high-income countries it can be seen that dependency rate exceeds the EU member states which are most affected by the economic crisis, such as Greece, Spain and Portugal. Compared to countries in transition, the rate of RS is quite high, the higher ones are only in Ukraine, Albania and Armenia. Other countries of the former Yugoslavia, Slovenia, Serbia, Macedonia and Montenegro, have significantly lower rates dependency rates than the RS.

A factor that significantly explains high dependency rate of the system is a low rate of coverage of the insured, as % of active working age population. This percentage of 29.1 is similarly low as in FBiH, and it is among the lowest ones in Europe. A low percentage of the insured in RS stands out clearly in comparison with countries with high incomes. Even in comparison with other countries in transition, as indicated by the small number of insured in RS, it is only comparable with Albania in Europe and Armenia and Azerbaijan in the former Soviet Union.

Poor labor market outcomes complicate the financing of social security programs in most of the above mentioned countries, requiring increasing transfers from the budget. It is likely that the pressures on social security programs will continue to increase, because the economic growth can be made without increase of jobs in the near future.

All these facts made entity authorities to approach to reforming the traditional approaches in this field in the last few years in order to adapt to new demographic circumstances and avoid possible larger disruptions of the system in the future. Of course, the first changes were related to the tightening of conditions for the acquisition of pension and disability insurance (more restrictive acquisition of a disability pension, audit of rights of RVI, etc.).

4. CONCLUSION

A key feature of the pension systems in BiH is a very high dependency rate of 1.1, ie. a pensioner is covered by only 1.1 insured person. The dependency rate of the FBiH compared to countries in transition from the region of Europe and Central Asia is even among the top three. A small number of the insured in FBiH coincides only with Albania in Europe and Armenia and Azerbaijan in the former Soviet Union. Countries in transition have higher rate dependency rate than countries that are not in transition for various reasons: the earlier age of retirement increases the number of pensioners. Looser definition of disability further increases the number of users. There is no doubt that the reason for poor economic indicators in our pension system, besides high unemployment and generally low standard, refers to corruption in the entire social security system (sincerely, the least in the PDI Fund), but there is certainly a big responsibility for absolute lethargy in the PDI Fund, to which Law provides incomes without reform from- voluntary pension insurance.

When it comes to the tax wedge, social contributions rates are much higher than all other taxes in BiH, and they are high in comparison with neighboring countries. The overall rate of social contributions in the FBiH amounted to 41.5% of gross wage. This is higher than in the RS (34.9%) or the OECD average (29.5%) or the EU-8 average (38.1 percent). Contribution rates are proportional and different from the standpoint of taxpayers and from the standpoint of the base.

Republic of Srpska and FBiH have very high dependency rate of the system. Comparing the rates of the RS to countries with high incomes, it can be seen that the rate of dependency exceeds members of the European Union which are the most affected by the economic crisis, such as Greece, Spain and Portugal. Compared to countries in transition, the rate of RS is quite high, only Ukraine, Albania and Armenia have the higher rate. Other countries of the former Yugoslavia, Slovenia, Serbia, Macedonia and Montenegro, have significantly lower rates depending on the RS.

Based on all the above stated in this paper, the unequivocal conclusion is imposed: we do not need reform of the Fund now, that is initiated from the outside, but we need immediate reform of the consciousness of the PDI Fund management, ie. transition of consumer consciousness from budgetary resources to active participants on the capital market and real estate market. This is certainly the premise that one could even talk about the voluntary pension insurance system and the accumulation system of capital contributions for the PDI.

It should be emphasized that the future success of the pension system does not depend on the chosen model, but it depends more on economic and political conditions, where the ability of the country has the central role, which is significantly different from one country to another in transition. There are bad indicators of the pension system, in no small number of countries in transition and it is usually enhanced by widespread corruption in the country administration. There is little reason for optimism in many countries, especially when it comes to newly introduced private pension system.

There are significant and numerous mechanisms of interaction of public and private sector, ie. establishment of private pension funds has a significant restoring influence on the public pension fund, primarily through a reduction of incomes and fiscal balance. On the basis of this, the transition countries that opt for the pension system reform should achieve considerable investment in human resources and improving the information system in advance. Also, if the minimum institutional requirements are not fulfilled the reform can become a dangerous strategy. The country has an important role in the privatization of the pension system, and special attention should be paid to this. Classic features of the country in mandatory private system include:

- 1) formation and implementation of the new pension system,
- 2) regulation and supervision of the work of pension funds, informing and reporting,
- 3) financing the transition costs,
- 4) providing implicit "pension guarantee as a last resource."

Additional functions that are sometimes given to the country are: conducting clearing (accounting) activities, sponsoring pension funds, providing disability and family pensions, and finally, the essential and general conditions in which the country has a central place in achieving macroeconomic and political stability.

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